No. 11874

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

In the matter of

CHRIST'S CHURCH OF THE GOLDEN RULE, a California Non-Profit Religious Corporation,

Bankrupt.

PETER PETERSEN, MRS. PETER PETERSEN and GEORGE D. PATRICK,

Appellants,

vs.

PAUL W. SAMPSELL, L. BOTELER and McINTYRE FARIES, as Trustees in Bankruptcy of the Estate of Christ's Church of the Golden Rule, Bankrupt, and CHRIST'S CHURCH OF THE GOLDEN RULE, BANKRUPT,

Appellees.

APPELLEES' BRIEF.

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APPELLEES' BRIEF.

To the Honorable Judges of the United States Circuit Court of Appeals for the Ninth Circuit:

Come now Paul W. Sampsell, L. Boteler, and McIntyre Faries, trustees in bankruptcy of the estate of Christ's Church of the Golden Rule, bankrupt, appellees herein, and in reply to the appellants' opening brief respectfully state as follows:

Statement of the Case.

In order to properly present their argument in support of the ruling of the court below, appellees deem it necessary to include herein a separate statement of the facts involved on this appeal. A rather unusual situation exists in the present case with respect to the transcript of record. After appellants made a motion to exclude certain matters from the printed record, this court issued the following order:

> "IT IS FURTHER ORDERED that counsel for appellants shall not be required to print the transcript of record in this cause; that counsel for respective parties shall print, as an appendix to their respective briefs those portions of the transcript of record on which they rely." [Appellees' Tr. 88.]

Subsequent to the entry of the foregoing order, pursuant to a stipulation of counsel, this court entered an order to the effect that in addition to those portions of the record which are printed by the appellants, and the appellees, respectively, and appended to their briefs, the court would consider the remaining documents and exhibits itemized in the designation of record of the appellants and in the counter-designation of the appellees, in their original form, without the necessity of the printing or other reproduction of said documents and exhibits. [Appellees' Tr. 90-91.]

By reason of the foregoing, transcript references mentioned in this brief may relate to either the appendix to appellants' brief (hereinafter referred to as "Appellants' Tr."), the appendix to this brief (hereinafter referred to as "Appellees' Tr."), or, to the original documents contained in the transcript certified to this court by the clerk of the court below (hereinafter referred to as "Tr.").

The bankrupt, a California corporation, was incorporated as a non-profit corporation pursuant to the provisions of the General Non-Profit Corporation Law of the State of California.[1] [See Articles of Incorporation, Appellees' Tr. 5-14.] Neither the Articles, nor the By-Laws [Appellees' Tr. 14-32] of the bankrupt, make any provision for the issuance of stock or for stockholders. The Articles provide for not less than three directors, for the appointment of a trustee or trustees by the founder members. [Appellees' Tr. 12, 13.]

Sub-paragraph "p" of paragraph second of the Articles provides [Appellees' Tr. 11]:

> "All by-laws, rules of procedure, appointment of officials and acts of any kind whatsoever, including the acts specified in the foregoing articles, by the officials, ministers, agents, representatives, associates or co-workers of this church organization pertaining in any way to the activities and/or interests of this corporation shall first be subject to the approval of the trustee or trustees which approval shall be expressed in writing and acknowledged before a notary public."

Paragraph Fifth of the Articles provides [Appellees' Tr. 12]:

> "The Founder Members shall appoint a trustee or trustees who shall thereafter have the power to appoint his or their successor or successors in whatever manner he or they may select by agreement, will or otherwise, providing that the instrument by which said successor, trustee or trustees is or are appointed shall be acknowledged before a notary public."

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[1]Formerly Article 1 of Title XII of the Civil Code of the State of California (Sections 593 to 605(e) inclusive) and now contained in Sections 9000 to 9802 of the Corporations Code of the State of California.

The By-Laws of the bankrupt contain provisions governing membership in the church corporation. Section 1 of Article Two of the By-Laws contains the following provision with respect to the rights of members [Appellees' Tr. 15]:

> "No member or official shall 'ever' have any personal, proprietary or legal right, title or interest in or to any properties, resources, assets or income of this Church; and it is specifically understood and agreed that whatever occupancy or use of Church property a member may be permitted to enjoy shall be subject solely to the discretion of its Board of Directors and trustee, or trustees—with no right of recourse of any kind whatsoever—and that upon a member's withdrawal, removal or decease, or upon demand of the Board of Directors and trustee, or trustees, all real or personal property in the possession of, or being used by, said member shall 'immediately' be relinquished to such member, or members, of this Church as may be authorized, in writing, to receive possession thereof by its Board of Directors and trustee, or trustees, in accordance with their own absolute discretion."

Section 1 of Article II of the By-Laws concludes as follows [Appellees' Tr. 17]:

> "After January 20, 1945, all members of this Church shall—as rapidly as is practical and possible under its By-Laws and procedure—be trained to represent it as missionaries and/or ministers. When, in the judgment of the Board of Directors and the Trustee, or Trustees, they are deemed qualified, they shall be duly ordained as ministers of Christ's Church of the Golden Rule. Pending such formal ordination, each and every member of this Church, after January 20, 1945, shall be considered as a student of the

teachings of Christ Jesus (as understood and promulgated by this Church) preparing to minister unto mankind in the way that this Church believes will most clearly and accurately exemplify the essence and major purposes of Christ Jesus' life work and ministry."

Section 2 of Article II of the By-Laws sets forth the classifications of members. [Appellees' Tr. 18-21.] There are five classes of members, to-wit:

Founder Members,
Advisory Members,
Managing Members,
Project Members,
Initiate Members.

Section 2 of Article VI of the By-Laws sets forth the powers of the trustee, or trustees, as follows [Appellees' Tr. 28]:

"The trustee, or trustees, of the corporation shall have the full and complete power (subject to his, her, or their sole discretion) to approve or disapprove any and all actions of the Board of Directors or of the officers of the corporation, such approval or disapproval to be in writing over the signature of the trustee, or trustees, and to be acknowledged before a notary public. If any action be taken by the corporation, its officers or directors without first obtaining the express written approval of the trustee, or trustees, as hereinabove mentioned, such action shall be null and void unless subsequently ratified by the trustee, or trustees, in the same manner as his, her or their approval would have been given."

On November 1, 1945, the bankrupt corporation filed a petition under Chapter XI of the Bankruptcy Act [Ap-

pellants' Tr. 2-11]; attached to and made a part of said petition and marked Exhibit "A" thereto [Appellants' Tr. 11-13] was a property statement of the bankrupt showing property belonging to the estate at the purchase price value of $2,956,110.50 with $1,731,230.50 being the unpaid balance of principal on said properties, leaving a net property value of $1,224,880.00; Exhibit "B" [Appellants' Tr. 14] to the aforesaid petition was a schedule of the unsecured creditors of the petitioner showing an indebtedness of $364,650.00. Also attached to the aforesaid petition was a certified copy of the resolution of the corporation authorizing the filing of the petition. [Appellants' Tr. 10.]

At the same time the bankrupt petitioned for an order authorizing the filing of the petition for arrangement under Chapter XI without the filing of a schedule of assets and liabilities, and a statement of affairs [Tr. 2], the petitioners stated in paragraph II thereof that "the vast holdings and operations by said corporation throughout the states of California and Oregon" made it impossible to file a schedule of assets and liabilities immediately. In the petition for arrangement it was alleged [Appellants' Tr. 5] "That generally your petitioner's assets consist of office buildings, hotels, sanitariums, churches, ranches, laundries . . ." In addition to the foregoing type of properties, Exhibit "A" attached to the petition [Appellants' Tr. 11] showed that the assets of the estate included canneries, unimproved real estate, beach clubs, hotels, residences, apartments, stores, creameries, warehouses, parking lots, garages, saw mills, a cheese factory, a fish hatchery, cattle, automotive and farming equipment, growing crops, cars and trucks.[2]

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[2]For a more detailed description, see the second account and report of the trustee [Appellees' Tr. pp. 32-81].

Thereafter, on November 15, 1945, the bankrupt filed a request for and consent to adjudication in the Chapter XI proceeding [Tr. 19-22], and, on the same day, it filed, in the same proceeding, its voluntary petition in bankruptcy [Appellants' Tr. 15], along with various schedules of its assets and liabilities. [Tr. 43.] The summary sheet attached to the schedules showed assets of $2,898,-460.58 and liabilities of $2,177,925.45; however, no tax claims other than excise tax claims were scheduled.

Along with these petitions there was filed a certified copy of a resolution of the bankrupt corporation authorizing the filing of the aforesaid petitions. [Appellants' Tr. 18.] This resolution was signed by A. L. Bell, president, director and sole trustee of the corporation, and by A. E. Knapp, as secretary-treasurer, and by A. P. Nordskott as vice-president and director.

On November 19, 1945, Honorable William C. Mathes, Judge of the District Court, dismissed the bankrupt's plan of arrangement under the Chapter XI petition and adjudged it a bankrupt. [Appellants' Tr. 24.] Thereafter, the matter was duly referred to Referee Benno M. Brink as the referee in the within proceedings. [Appellants' Tr. 25.]

On November 19, 1945, J. Ray Files, Stewart McKee and Paul W. Sampsell were duly appointed receivers of the estate of the bankrupt. [Tr. 79.]

On January 4, 1946, Messrs. Paul W. Sampsell, L. Boteler, and Stewart McKee were duly elected by the majority of the voting creditors in both number and amount, and they qualified as the trustees in this proceeding. Subsequently, Stewart McKee resigned as trustee and was succeeded by McIntyre Faries. [Tr. 289.]

Thereafter the estate of the bankrupt was administered by the Bankruptcy Court through the aforesaid trustees,

which involved the commencement of ancillary proceedings in the Northern District of California [Tr. 94-96] and in the District of Oregon. [Tr. 85-86.] Extensive and protracted litigation has been carried on by and against the trustees in connection with the bankruptcy administration, and the estate is still being administered by the bankruptcy court. More than two million dollars have been received and disbursed by the trustees. [Appellees' Tr. 52.] The extensive properties of the bankrupt's estate have been operated, leased and/or sold under the supervision of the bankruptcy court. [Appellees' Tr. 38-44.] The appellants were aware of the pendency of the bankruptcy proceeding since its inception on November 1, 1945. [Appellants' Tr. 124.][3]

On or about October 24, 1947, the appellants herein served upon the trustees a notice of motion to set aside the adjudication in bankruptcy, and indicated in said notice that the motion would be made and based upon the following grounds. [Appellants' Tr. 26-29.]

1. That the corporation was not a proper subject to be adjudicated a bankrupt.

2. That there was no proper authority or consent by the necessary corporate officers for the voluntary petition for adjudication.

3. That the consent to the voluntary petition for adjudication was obtained through the misunderstand- by the corporate officials of the nature of the proceedings to which they consented.

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[3]The Court below so found in its findings of fact contained in the order denying appellants' motion to set aside the adjudication, and, appellants have made no objection to this finding either in the court below or on appeal [Appellants' Tr. p. 124].

4. That the adjudication was somehow a violation of the United States Constitution as a result of the manner in which the estate was administered by the Bankruptcy Court and the trustees, subsequent to the order of adjudication.

A hearing was held on said motion before the Honorable William C. Mathes on November 14, 1947, and the moving parties, the appellants herein, made an offer of proof with respect to matters pertaining to the administration of the bankrupt's estate subsequent to the adjudication in bankruptcy. [Appellants' Tr. 44-81, 112.]

While the offer of proof was very lengthy, everything therein contained can be divided into two categories, the first being alleged religious persecution in connection with the bankruptcy administration, and secondly, misconduct of the trustees and other officers of the court as a part of the administration. The moving parties requested that the court take judicial notice, which it did, of all the records and prior proceedings in the case in connection with the motion.[4] In a written order dated November 14, 1947 [Appellants' Tr. 122-126], Judge Mathes denied the motion and made the following findings of fact:

1. That the moving parties had knowledge of the bankruptcy proceedings since their inception.

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[4]This was proper. In the case of *McDonough v. Owl Drug Co.* (C. A. A. 9th, 1935), 75 F. 2d 45, *cert. den.* 295 U. S. 750, this Court stated that it was proper for the trial court, in connection with a motion to vacate an adjudication on the ground of extrinsic fraud "to take judicial cognizance of the records and files of the bankruptcy proceeding in which the petition was filed. . . . Here the petition under review was filed by appellants in the bankruptcy proceeding, and it would be going far to say that, in exercising discretionary powers to protect itself against fraud, a court may not take judicial cognizance of the very proceedings in connection with which this action is invoked." (75 F. 2d at 51.)

2. That the administration was complicated, involving the receipt and disbursement of over two million dollars, and the sale of real and personal property with the result that a setting aside of the adjudication would cause "almost inextricable confusion with respect to the titles of such real and personal property and cause serious financial loss to many innocent persons."

3. That the adjudication followed the filing of a voluntary petition in bankruptcy which was regular on its face, and which contained all the essential jurisdictional allegations.

4. That the corporate officials who caused the petition to be filed fully understood the nature and character of the bankruptcy proceedings and the adjudication which followed.[5]

Upon the basis of these findings, the court concluded that it had jurisdiction to make the adjudication; that it was regular on its face; and, that the moving parties were guilty of laches in presenting their motion.

This appeal followed.

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[5]We should like to point out a typographical error contained on page 125 of the printed transcript appended to appellants' brief. Finding No. 4, should read:

"4. The said Arthur L. Bell and the bankrupt corporation did, at and prior to the filing of the voluntary petition herein, fully understand the nature and character of these bankruptcy proceedings and the said adjudication in bankruptcy, and were fully and correctly informed with respect thereto, prior to such adjudication, and prior to the commencement of this bankruptcy proceeding by competent counsel."

This error occurred by reason of the fact that an incorrect copy of the order was certified to this Court by the Clerk of the District Court, but that error has since been corrected by the Clerk of the District Court.

Summary of Argument.

The ruling below should be affirmed on the following grounds:

1. The moving parties, the appellants herein, have shown no such legal interest or right of representation in the bankruptcy proceedings as would entitle them to any relief.

2. The bankrupt corporation was a proper subject to be adjudicated a voluntary bankrupt.

3. The voluntary petition in bankruptcy filed by the bankrupt corporation was regular on its face and was a proper and duly authorized act of the corporation.

4. The corporate officers who caused the voluntary petition to be filed, at and prior to the filing of the voluntary petition herein, fully understood the nature and character of bankruptcy proceedings and the adjudication that followed, and were fully and correctly informed by competent counsel with respect thereto prior to such adjudication and prior to the commencement of this bankruptcy proceeding.

5. The appellants, with full knowledge of the facts, acquiesced and participated in the bankruptcy proceedings from their inception for a period of approximately 2 years before making any objection to the regularity of the adjudication, and, have thereby been guilty of laches so as to preclude any possible right to the relief they seek.

6. Vacating and setting aside the order of adjudication is not the proper remedy for any alleged misconduct of the trustees or other officers of the Bankruptcy Court in the administration of the bankrupt estate subsequent to the order of adjudication.

7. The exercise of the power to vacate an adjudication rests in the sound discretion of the Bankruptcy Court, reviewable only for a clear abuse of that discretion; no abuse of discretion is shown in the present record.

I.

The Moving Parties, the Appellants Herein, Have Shown No Such Legal Interest or Right of Representation in the Bankruptcy Proceedings as Would Entitle Them to Any Relief.

There is nothing in the record to indicate that the appellants had any interest whatsoever in the bankruptcy proceedings either as members or creditors of the bankrupt corporation. While it is stated parenthetically on page 1 of appellants' opening brief that appellants are "individuals in the religious society" there is neither evidence nor allegation in the entire record to support this statement.[6]

The record before the court is voluminous, and nothing therein contained shows that the appellants have an interest in the bankruptcy proceedings, nor does appellants' brief contain any reference to any portions of the record showing any interest of the appellants[7]. In order to entitle any person to move the bankruptcy court for an order vacating and setting aside the adjudication in bankruptcy, the moving party must show some interest in the proceedings.

In the matter of *Fox West Coast Theatres*[8] (C. C. A. 9th, 1937), 88 F. 2d 212, 33 A. B. R. (N. S.) 471, *cert.*

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[6]The express provisions of the rules of this court are to the effect that the court will consider nothing but those parts of the record designated by counsel to be included in the printed transcript. Subsection 6 of Rule 19 of the Rules of the Circuit Court of Appeal for the 9th Circuit. See also: *Sampsell v. Anches,* C. C. A. 9th, 1939, 108 F. 2d 945, 42 A. B. R. (N. S.) 78.

[7]Subsections 2(b) and (f) of Rule 20 of the Rules of the Circuit Court of Appeals for the Ninth Circuit require such references.

[8]Cited on page 23 of Appellants' Opening Brief.

den. 301 U. S. 710, appellant had moved the bankruptcy court for an order vacating a voluntary adjudication in bankruptcy by a corporation, and, in affirming the lower court's denial of the motion, this court stated the following as one of the grounds for its decision:

> "In order to invoke the extraordinary powers of a court of equity to vacate or ignore an order, because procured by extrinsic fraud, the party making the attack must show injury by the order. No such injury is shown." (88 F. 2d at 231.)

No argument we could make could so clearly state the principles involved as did the 8th Circuit Court of Appeals in the case of *Smith v. The Chase National Bank of the City of New York* (1936), 84 F. 2d 608, 31 A. B. R. (N. S.) 472.[9] In that case the appellants were bondholders of a holding company, whose subsidiaries had been voluntarily adjudicated bankrupts. The appellants took an appeal from the District Court's denial of their motion to set aside the adjudication of the subsidiaries. In affirming the trial court, the 8th Circuit Court of Appeals stated as follows (84 F. 2d at 613):

> "It is necessary to decide whether the general rules of law upon which the appellants rely are here applicable. The Appellants are not, in any proper sense, parties to the bankruptcy proceedings. They are not creditors of the bankrupt, nor stockholders; nor have they any legal title or right to possession of the assets. They have no lien upon the assets by virtue of any contracts or dealings with the bankrupts. They are bondholders of General Theatres, which once owned a majority of the stock of Fox Film, which

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[9]Cited on page 23 of Appellants' Opening Brief.

in turn owned stock of Wesco, which owned the stock of the bankrupts and other subsidiary corporations. Appellants say that the Chase National Bank bore a fiduciary relation to the bondholders of General Theatres, and, wrongfully and in violation of its trust, acquired from it stock of Fox Film and thus became a constructive trustee for the appellants and other bondholders of the stock so improperly acquired; that the bank, by using this stock to control the affairs of Fox Film, and, through it, the affairs of its subsidiaries, even unto the third or fourth generation, for its own selfish advantage, has now become, as between itself and the bondholders, in equity, a trustee of the physical assets which underlie this pyramid of corporate structures; and that in this suit by the appellants, all corporate forms will be discarded, and the physical assets of the bankrupts and other similar subsidiaries treated as in the possession of the Chase National Bank as trustee for the bondholders of General Theatres. They assert that a part, at least, of these trust assets are in the custody of the court of bankruptcy by reason of the fact that the bank caused the bankrupts, who were two of its creatures, to file voluntary petitions, and that it then caused another of its creatures to buy up the claims of creditors and use them in purchasing the assets from the trustee in bankruptcy. According to the petitions, as we analyze them, the Chase National Bank, if the sales of the assets are completed, will have succeeded in passing the assets of the bankrupts, which, according to the allegation of the appellants' petitions, it in equity owned, controlled and held in trust for appellants and other bondholders, through the court of bankruptcy (thereby freeing such assets from the claims of creditors of the bankrupts for less than the claims were worth) to another corporation which it has created and owns

and controls. Hence, according to the petitions, the net effect of what the bank will have accomplished if the sales go through, will be about the equivalent of its having passed these assets from its right hand to its left hand. What the appellants seek by their petitions is an order or decree requiring the bank to pass the assets back to its right hand, or a decree that the bank hand them over to the bondholders of General Theatres to be applied on their bonds.

It would be difficult to imagine a controversy in which the court below would have less practical reason to be interested. For more than two years before the appellants' petitions were filed, it had been administering these assets, and, through its officers, conducting the extensive business of the bankrupts. It had collected their assets, and passed upon the claims of their creditors, all of which had been paid, purchased, or in some way satisfied by the time the appellants' petitions were filed. The title of the trustee in bankruptcy to the assets was marketable, so that the assets could be sold, and offers had been made for them, which the court determined should be accepted. The proceedings were about to be terminated, when these bondholders of General Theatres, a holding company —a sort of corporate parent twice removed from the bankrupts—filed their petitions. The controversy which they initiated was of no interest to the creditors of the estates or to the bankrupts, of no consequence to the trustee in bankruptcy, and certainly of no importance to the court so far as the administration of the estates in bankruptcy was concerned. The bankrupts, when the appellants' petitions were filed, were about to take their departure from the court through the exit, and no useful purpose would be served by forcing them to walk backwards and leave by the en-

trance. Many things had been done during the course of administration which could not be undone. Services had been rendered and expenses incurred by the officers of the court which had been paid for or were to be paid for out of these assets or by their purchaser, and the fraud alleged to have been perpetrated by the Chase National Bank upon the appellants did not and could not deprive the court of its jurisdiction of these estates or of its right to terminate these bankruptcy proceedings in the regular way if it saw fit to do so. An application to vacate an adjudication under such circumstances is clearly addressed to the discretion of the court of bankruptcy. McDonough *et al.* v. Owl Drug Co. *et al.* (C. C. A. 9th Cir.), 75 F. (2d) 45, 53, certiorari denied McDonough *et al.* v. Owl Drug Co. *et al.*, 295 U. S. 750; Banco Commercial De Puerto Rico v. Hunter Benn & Co. (C. C. A., 1st Cir.), 14 Am. B. R. (N. S.) 95, 31 F. (2d) 921; Ewing *et al.* v. Forrester Nace Box Co. *et al.* (C. C. A. 8th Cir.), 7 Am. B. R. (N. S.) 767, 12 F. (2d) 864; In re De Lue (C. C. A. 1st Cir.), 3 Am. B. R. (N. S.) 479, 295 F. 130, 132; In re First National Bank of Belle Fourche *et al.* (C. C. A. 8th Cir.), 18 Am. B. R. 265, 152 F. 64.

Assuming, without deciding, that appellants had a sufficient interest in the proceedings to ask that the adjudications be vacated, we are satisfied that, under the circumstances, the court was guilty of no abuse of discretion in refusing to entertain the petitions in so far as they sought to vacate the adjudications."

While in certain cases stockholders[10] of a bankrupt corporation, upon making a proper showing, may have an adjudication set aside, in the instant case there is nothing

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[10]See, for example:

Zeitinger v. Hanardine-McKittrick Dry Goods Co. (C. C. A. 8th), 244 Fed. 719, cert. den. 245 U. S. 667, 38 S. Ct. 64;
Hanna v. Brictson Mfg. Co. (C. C. A. 8th), 62 F. 2d 139;
McDonough v. Owl Drug Co. (C. C. A. 9th), 75 F. 2d 45, cert. den. 295 U. S. 750, 55 S. Ct. 829.

This Court, in the case of *McDonough v. Owl Drug Co.* (C. C. A. 9th 1935), 75 F. 2d 45, made it clear that the right of stockholders to have an adjudication set aside is subordinate to the rights of creditors in a bankruptcy proceeding. In that case preferred stockholders sought to have a voluntary adjudication in bankruptcy of the corporation vacated seventeen months after the adjudication and five months after the bankrupt's property had been sold in a bankruptcy liquidation sale. The ground upon which the motion to vacate the adjudication was based was that extrinsic fraud had been committed by certain stockholders of the bankrupt corporation, which was a fraud on the bankruptcy court. In affirming the district court's denial of the motion, this court stated (75 F. 2d at 52):

> "No creditor of the bankrupt has joined with appellants in seeking to have the adjudication of bankruptcy annulled, but on the contrary the trustee, conceiving that it is primarily his duty to protect the rights of creditors, is vigorously opposing the setting aside of the adjudication. It may be granted that preferred stockholders of a corporation are competent to file a petition in a bankruptcy proceeding attacking an order adjudging such corporation a bankrupt on the ground that such order was procured by fraud and imposition, and may in that manner invoke the incidental equity powers of a court of bankruptcy in the premises. Such a challenge, however, must be based upon such grounds as will appeal to the conscience of a chancellor and must be seasonably interposed. . . . Let it not be forgotten that in liquidating a bankrupt corporation the rights of creditors come first. The interest of corporate stockholders in such proceedings are always secondary and subordinate to the interests of the corporate creditors. . . . No creditor is complaining. No creditor has manifested any dissatisfaction with the adjudication, nor with the steps which have been taken in liquidating the estate. . . . In these circumstances it would be inequitable, unconscionable, and unjust to subject the creditors to the evils and hazards which the cancellation of the adjudication would unavoidably entail. The creditors of the bankrupt corporation are not involved in the fraud upon which appellants rely."

in the record to reveal any interest of the appellants in the bankruptcy proceedings other than the irrevelant statement in their brief, *dehors* the record, that they are "individuals in the religious society." Upon this ground alone the ruling below should be affirmed.

II.

The Bankrupt Corporation Was a Proper Subject to Be Adjudicated a Voluntary Bankrupt

In the present case the adjudication followed the filing of a voluntary petition by the corporation. As stated by this court in the matter of *Fox West Coast Theatres* (C. C. A. 9th, 1937), 88 F. 2d 212, 33 A. B. R. (N. S.) 471, *cert. den.* 295 U. S. 750:

> "Before considering appellants' contentions in detail, it should be stated that the adjudication of bankruptcy necessarily and properly resulted from the filing of the petition in bankruptcy. The property of the bankrupt was rightfully in the possession of the bankruptcy court and the filing of the voluntary petition was authorized by the bankrupt. We have already pointed out that although the alleged purpose of the conspiracy was to make the bankrupt appear insolvent, appellants now concede, as they must, that it is not necessary for a voluntary bankrupt to be insolvent in order to take advantage of the provisions of the Bankruptcy Act. It should further be observed that although appellants charge that the bankrupt and its stockholders 'conspired' or agreed with one another to take advantage of the provisions of the Bankruptcy Act, such an agreement is lawful." (88 F. 2d at 221.)

It should be noted at the outset that the adjudication herein was based upon a voluntary petition. The Bank-

ruptcy Act (11 U. S. C. A. Section 22), clearly sets forth the qualifications for becoming a bankrupt. Thus Section 4(a) provides "any person, except a municipal, railroad, insurance, or banking corporation, or a building and loan association, shall be entitled to the benefits of this Act as a voluntary bankrupt." Subsection (b) of the same section limits the persons who may become involuntary bankrupts to "any natural person" or "commercial corporation." A mere reading of these two sections reveals the significance of the omission of any limitation, other than the express exceptions, on the persons who may become voluntary bankrupts. Subsection 23 of Section 1 of the Bankruptcy Act (11 U. S. C. A. 1) defines persons as including "corporations" except where otherwise specified. Accordingly, the word "person" as used in Section 4(a) includes corporations, and the cases have held that corporations of every kind except those expressly excluded, regardless of their purposes or the laws under which they were incorporated, are entitled to become voluntary bankrupts. Thus, in the matter of *Carthage Lodge* (D. C. N. Y., 1916), 230 Fed. 694, 36 A. B. R. 873, the court made the following analysis of the foregoing statutory provisions,[11] in holding that the Independent Order of

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[11]While the Bankruptcy Act has been amended since that decision, there was no change whatsoever in the section there construed. That section then read:

> "Any person except a municipal, railroad, insurance, or banking corporation, shall be entitled to the benefits of this Act as a voluntary bankrupt."

The present section and the one involved on this appeal is exactly the same, except there has been added to the exceptions the following language:

> "or, a building and loan association."

Moreover, the word "persons" and the word "corporations" (Comp. St. 1913, Sec. 9585) were defined in the statute there being construed in the identical language as those terms are defined in the present statute (Section 1(8) (23) 11 U. S. C. A. 1).

Odd Fellows, a fraternal organization, could become a voluntary bankrupt (230 Fed. at 698):

> "It is clear, therefore, that *any corporation or partnership* is entitled to the benefits of the act, and may file a voluntary petition in bankruptcy, except a 'municipal, railroad, insurance or banking corporation.' The Bankruptcy Act of 1867, as to those entitled to the benefits of the act, was narrower than is the act of 1898, as amended in 1910, as that act of 1867 limited the benefits of the act in case of voluntary bankrupts to 'moneyed, business, or commercial corporations.' The corporations entitled to the benefits of the act of 1898 as voluntary bankrupts are not limited to moneyed, business or commercial corporations. Municipal, railroad, insurance, and banking corporations only are excluded from the benefits of the act of 1898, as amended, as *voluntary* bankrupts. When we come to subdivision 'b' of section 4, we find that *only* moneyed, business, or commercial corporations, excepting therefrom municipal, railroad, insurance and banking corporations, may be proceeded against in *involuntary* bankruptcy.
>
> The question then is: Is the Carthage Lodge, No. 365, Independent Order of Odd Fellows of Carthage, N. Y., a person or corporation within the meaning of said Bankruptcy Act? Such lodge certainly has some of 'the powers and privileges of private corporations not possessed by individuals or partnerships.' It is a creation of the statutes of the State of New York. Its purposes, generally speaking, are benevolent or charitable in character. It has power to elect trustees to manage its affairs. These trustees may take, hold, and convey, under its direction, all the temporalities and property belonging to it, whether real or personal, and may sue for and recover, hold and enjoy same in whatsoever manner the same may have been acquired,

and may demise, lease, and improve all such property, real or personal. These trustees hold for the lodge, and are subject to its directions. It may make rules and regulations for managing its temporal affairs and for the disposition of its property, etc. There is no express power to incur debts generally, but this power for corporate purposes is plainly implied, and its property is liable for the payment of such debts."

* * * * * * * *

"Indeed, if a business, a moneyed, a trading, or a manufacturing institution organized under and pursuant to the laws of the State and owning property and owing debts is entitled to the benefits of the Bankruptcy Act, it is difficult to understand why an educational, beneficial, fraternal, or charitable institution organized under the laws of the same State and owning property and owing debts lawfully contracted may not have the benefits of the act. Certainly it is no more in the interest of the general public that the one have the benefits of the act than that the other have. Why should the latter class of corporations mentioned be ruined and driven out of business by the burden of their debts, while the business, commercial, manufacturing, and moneyed corporations are permitted to take the benefits of the Bankruptcy Act and start business anew? I do not think Congress intended any such differentiation, and I am not aware of any rule of public policy which requires a construction of the Bankruptcy Act different from the one I am giving it. In fact I am unable to see that the statute is at all equivocal.

"Within section 4a, read with section 1(6) and section 1(19), all corporations are persons, and within the purview of the act, except municipal, railroad, insurance, and banking corporations, and entitled to

> the benefits of the act as voluntary bankrupts, and, as stated, the law does not concern itself with the nomenclature in the statute creating such corporations. If it did, a lodge of Odd Fellows created under the laws of Massachusetts would be entitled to the benefits of the act, if there called 'a corporation,' while such a lodge, with exactly the same powers and privileges, would not be if created under a precisely similar statute of Pennsylvania, if in such statute called a beneficial association or by some other name."

A similar result was reached in the *Matter of Philadelphia Consistory Sublime Princes Royal Secret 32 Degree Ancient Accepted Scottish Rite* (U. S. D. C. Penna. 1941), 40 Fed. Supp. 645, 53 A. B. R. (N. S.) 374, where the court wrote a scholarly opinion in holding that "an unincorporated beneficial association," whose function was to give "various funds, aid and support to those of its members and members' families" who were in need, was a proper subject to be adjudicated a voluntary bankrupt. There are numerous cases in accord.[12]

In the present case the bankrupt was a corporation duly organized and existing under and by virtue of the general

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[12]*Matter of S. & F. Mfg. Sales Co.* (D. C., Ohio), 246 Fed. 1005, 39 A. B. R. 783; *Matter of Elmsford Country Club* (D. C. N. Y.), 50 F. 2d 238, 17 A. B. R. (N. S.) 558 (a country club); *Matter of Grand Lodge Ancient Order of United Workmen* (D. C. Cal.), 232 Fed. 199, 36 A. B. R. 634 (Benevolent Order); *Matter of Michigan Sanitarium & Benevolent Association* (D. C. Mich.), 20 Fed. Supp. 979, 36 A. B. R. (N. S.) 627 (Benevolent Order); *In re Prudence Co. Inc.* (D. C. N. Y.), 27 A. B. R. (N. S.) 471, 10 Fed. Supp. 33, affirmed (C. C. A. 2d), 29 A. B. R. (N. S.) 549, 79 F. 2d 77, cert. denied 296 U. S. 646; *Hoile v. Unity Life Insurance Co.* (C. C. A. 4th, 1943), 53 A. B. R. (N. S.) 37, 136 F. 2d 133.

See also:

1 Collier on Bankruptcy (14th Ed.), pages 583 to 587.

non-profit corporation law of the state of California. The record discloses that the bankrupt was engaged in numerous and various business activities. The bankrupt owned and operated office buildings, dairies, laundries, lumber mills, restaurants, hotels, shops, garages and numerous other ordinary commercial activities. These activities were expressly authorized by the bankrupt's Articles of Incorporation,[13] and were in accordance with the California law governing nonprofit corporations. In Section 9200 of the Corporations Code of the State of California[14] under which the bankrupt herein was incorporated, it is provided:

> ". . . carrying on business at a profit as an incident to the main purposes of the corporation and the distribution of assets to members on dissolution are not forbidden to nonprofit corporations."[15]

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[13]See paragraph Second, subsections "f", "h", "i", "k", "n" and "o" of Articles of Incorporation of the bankrupt [Appellees' Tr. pp. 8-11].

[14]Formerly Section 593 of the Civil Code of the State of California.

[15]See also Section 9501 of the Corporations Code of the State of California (formerly Civil Code Section 593) providing as follows:

"Every nonprofit corporation may:

(a) Sue and be sued.

(b) Make contracts.

(c) Receive property by devise or bequest, subject to the laws regulating the transfer of property by will, and otherwise acquire and hold all property, real or personal, including shares of stock, bonds, and securities of other corporations.

(d) Act as trustee under any trust incidental to the principal objects of the corporation, and receive, hold, administer, and expend funds and property subject to such trust.

(e) Convey, exchange, lease, mortgage, encumber, transfer upon trust, or otherwise dispose of all property, real or personal.

(f) Borrow money, contract debts, and issue bonds, notes, and debentures, and secure the payment or performance of its obligations.

(g) Do all other acts necessary or expedient for the administration of the affairs and attainment of the purposes of the corporation."

On the basis of the numerous commercial activities carried on by the bankrupt corporation involuntary proceedings in bankruptcy might have been instituted against it. *Matter of Roumanian Workers Educational Association of America* (C. C. A. 6th, 1940), 108 F. 2d 782, 42 A. B. R. (N. S.) 34.[16]

The Supreme Court of California has recognized that religious non-profit corporations are amenable to suit and to other obligations of ordinary commercial corporations with respect to any of their secular activities. Certainly persons dealing with any of the numerous business enterprises carried on by the bankrupt could not be precluded from any remedy for breaches of any business obligations by the Church corporation.

In *Roman Catholic Archbishop of San Francisco v. Industrial Accident Commission* (1924), 194 Cal. 660, the court affirmed an award of the Industrial Accident Commission in favor of a carpenter and against the *Roman Catholic Archbishop of San Francisco,* a corporation sole, for whom the carpenter had performed labor in the course

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[16]In that case the Court affirmed a denial of a motion to vacate an involuntary adjudication of a Michigan non-profit corporation which had been organized "for the propagation of Socialism among the Roumanian workers of the country." The evidence showed that the corporation was engaged in extensive activities of a commercial and business nature. The court held that non-profit corporations, not being expressly excluded from the operation of Section 4(b) of the Act, where they engaged in commercial activities could be adjudicated an involuntary bankrupt, and that the corporation was "a business and commercial corporation within the purview" of the Act.

of which he was injured. In reaching this conclusion the court uses the following language, which is particularly appropriate to the instant case (194 Cal. at 677):

> "Courts will take judicial notice of the existence of private corporations created by public law. (15 R. C. L. 1117; 11 Fletcher on Private Corporations, 584-587; Civ. Code, titl. XII, secs. 593-602.) A corporation formed under title XII of the Civil Code has civil rights and duties and its powers, like those of other corporations, are construed with reference to the object of the corporate existence. (Harriman v. Church, 63 Ga. 186 (36 Am. Rep. 117).) Section 602 of the Civil Code provides, in part: 'Whenever the rules, regulations, or discipline of any religious denomination, society, or church so require, for the administration of the temporalities thereof, and the management of the estate and property thereof, it shall be lawful for the bishop . . . to become a sole corporation, in the manner prescribed in this title, as nearly as may be, and with all the powers and duties, and for the uses and purposes in this title provided for religious incorporations. . . . Every corporation sole shall, however, for the purposes of the trust, have power to contract in the same manner and to the same extent as a natural person, and may sue and be sued, . . . and shall have authority . . . to buy . . . and in every way deal in real and personal property in the same manner that a natural person may . . .' Such powers are entirely distinct from the spiritual side of the church, and in order that a religious society be recognized by law it must be shown that it is capable of making contracts, accepting benefits, and of suing and being sued. (*Baxter v. McDonnell,* 155 N. Y. 83 (40 L. R. A. 670, 49 N. E. 667.)"

III.

The Voluntary Petition in Bankruptcy Filed by the Bankrupt Corporation Was Regular on Its Face and Was a Proper and Duly Authorized Act of the Corporation.

A certified copy of the resolution of the Board of Directors of the bankrupt corporation was filed with the voluntary petition in bankruptcy. The resolution authorized the filing on behalf of the corporation of a voluntary petition in bankruptcy with a request that an adjudication in bankruptcy be had. [Appellants' Tr. 19.] The certificate attached to the resolution certified that it was adopted by the Board of Directors of the corporation at a duly and regularly called and held meeting of said directors and that said resolution appears in the minutes of the meeting and had never been revoked or modified. The certificate was signed by A. L. Bell as President, Sole Trustee and Director, A. E. Knapp as Secretary-Treasurer of the corporation, and A. P. Nordskott as Vice-President and Director.

The petition and the resolution were in strict compliance with the law of the State of California and the articles and by-laws of the bankrupt. Thus, in Section 9500 of the Corporations Code of the State of California[17] it is provided:

> "Except as otherwise provided by the Articles of Incorporation or the by-laws, the powers of a non-profit corporation shall be exercised, its property controlled, and its affairs conducted, by a board of not less than three directors."

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[17]Formerly Section 593 of the Civil Code of the State of California.

The articles of the bankrupt [paragraph Fourth thereof, Appellees' Tr. 11] call for a board of directors of not less than three persons.

Subsection "p" of paragraph Second of the Articles provides that all acts of the corporation by any officials thereof "shall first be subject to the approval of the trustee or trustees." [Appellees' Tr. 11.] Article 5, Section 1 of the by-laws of the bankrupt provides:

> "All corporate powers shall be exercised by, or under the authority of, and the business affairs of the corporation shall be controlled by, the board of directors; provided, however, that the board of directors shall not legally obligate the church by the sale, hypothecation, or encumbering of any of the real or personal property or income or other resources of the church . . . without first obtaining the express approval of the trustee or trustees. . . ."

In the instant case Mr. A. L. Bell was the sole trustee. He signed the voluntary petition in bankruptcy [Appellants' Tr. 16] and signed the certificate attached to the resolution of the board authorizing the filing of the petition in bankruptcy, as President, Director and Sole Trustee. [Appellants' Tr. 20.] There is nothing in the record, or in the laws of the State of California or of the United States requiring the consent of any other persons.

Appellants argue, however, that the proper consent of the corporation was not obtained, and apparently rely upon the following provisions of the Corporations Code of the State of California:

Section 9800 of the Corporations Code of the State of California provides that:

> "A non-profit corporation may dispose of all or substantially all of its assets, or may be wound up or

dissolved, or both, in the same manner and which the same effect as a stock corporation, under the General Corporation Law."

Section 3901 of the Corporations Code provides that:

"A corporation shall not sell, lease, convey, exchange, transfer, or otherwise dispose of all or substantially all of its property and assets except in accordance with one of the following subdivisions:

. . .

(b) Under authority of a resolution of its board of directors and with the approval of the principal terms of the transaction and the nature and amount of the consideration by vote or written consent of shareholders entitled to exercise a majority of the voting power of the corporation.

However, the articles may require for such approval the vote or consent of a larger proportion of the shareholders, or the separate vote of a majority or a larger proportion of any class or classes of shareholders."

Although, as we shall hereinafter demonstrate, this section can have no application to a voluntary petition in bankruptcy, in any event the appellants herein have shown no such interest in the proceeding as to have any right to complain of any alleged lack of compliance with the above mentioned code sections. The California Courts have construed this code section as giving a right to complain only to stockholders and perhaps to creditors.[18]

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[18]*Gunther v. Thompson* (1931), 211 Cal. 631;
Lost Burros Gold Mining Co. v. Inyo County Bank (1927), 83 Cal. App. 679.

The United States Supreme Court has unequivocally held, however, that such a code section has no application to the filing of a petition in bankruptcy. In the case of *Royal Indemnity Co. v. American Bond & Mortgage Co.* (1933), 289 U. S. 165, 53 S. Ct. 551, 22 A. B. R. N. S. 590, the Supreme Court stated the question before it as follows:

> "Have creditors standing to ask the vacation of an adjudication based on a petition filed by authority of the directors of the bankrupt [a Maine corporation], where a statute of the state of incorporation forbids transfer, except in the usual course of business, of the franchises or assets of the company, without stockholders' assent?" (289 U. S. at 166.)

In answering the question in the negative and affirming the lower court's denial of the creditors' motion to vacate the adjudication, the court states as follows:

> "Second: The revised Statutes of Maine, chap. 56, under the caption 'Rights of Minority Stockholders,' enact:
>
> > 'Sec. 63. Corporations not to sell franchises or entire property without consent of stockholders. No corporation shall sell, lease, consolidate or in any manner part with its franchises, or its entire property, or any of its property, corporate rights or privileges essential to the conduct of its corporate business and purposes, otherwise than in the ordinary and usual course of its business, except with the consent of its stockholders at an annual or special meeting, the call

> for which shall give notice of the proposed sale, lease or consolidation. All such sales, leases and consolidations shall be subject to the provisions of this and the eleven following sections, and to the prior lien of stockholders as therein defined.'
>
> After providing that the act shall not apply to mortgages of corporate property, the sections following regulate methods of effecting consolidations, the valuation and payment for the stock of dissenting minority stockholders, etc. We are told that this statute prohibits the filing of a voluntary petition in bankruptcy by authority of a resolution of the board of directors, and that a shareholders' vote is required to authorize such action. No case decided by the Maine courts is cited in support of this assertion. But it is said that the filing of such a petition is a conveyance of all of the corporate property, and so plainly within the statutory prohibition. We cannot agree. The petition in a voluntary or involuntary proceeding is a pleading. The entry of an adjudication vests title in the trustee, and this is the act of the court, not of the petitioner. Moreover, it seems too plain to need elaboration that the statute does not in terms effect the initiation of a bankruptcy proceeding, and was passed for a wholly different purpose." (289 U. S. at 170.)

It will be noted that the Maine statute, which was before the Supreme Court, is substantially the same as the California statute. There can be no doubt that the decision of the Supreme Court is determinative of the

question raised by appellants herein as to the propriety of the resolution authorizing the filing of the voluntary petition.

Throughout appellants' opening brief, mention is made of the fact that the bankrupt was not insolvent at the time of the filing of the petition.[19] Insolvency is not a necessary prerequisite to an adjudication in bankruptcy on a voluntary petition, and this Court has squarely so held in the *Matter of Fox West Coast Theatres* (C. C. A. 9th, 1937), 88 F. 2d 212, *cert den.* 301 U. S. 710. In that decision this Court quotes with approval the following statement from *Remington on Bankruptcy,* Section 48, page 88:

> "Insolvency not requisite to voluntary bankrupt.—Nor is it necessary that he (the petitioner) be insolvent. The reason of this is probably that, if he be solvent, it is nobody's business but his own if he chooses to have his creditors paid through the machinery of the bankruptcy court; and if on the other hand he be actually insolvent, why then he ought to go into bankruptcy."[20] (88 F. 2d at 218.)

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[19]While the schedules originally filed in the bankruptcy proceeding by the bankrupt did not show insolvency, it should be noted that none of the schedules included state and federal tax claims (other than excise taxes) and alleged labor claims which were subsequently filed and which, if allowed, will result in insolvency. See Second Account and Report of Trustees [Appellees' Tr. p. 45].

[20]Accord: *Peoples National Bank v. Feltz* (C. C. A. 6th, 1928), 25 F. 2d 295, 12 A. B. R. (N. S.) 109.

IV.

The Corporate Officers Who Caused the Voluntary Petition to Be Filed, at and Prior to the Filing of the Voluntary Petition Herein, Fully Understood the Nature and Character of Bankruptcy Proceedings and the Adjudication That Followed, and Were Fully and Correctly Informed by Competent Counsel With Respect Thereto Prior to Such Adjudication and Prior to the Commencement of This Bankruptcy Proceeding.

On the basis of the undisputed facts in the record there can be no doubt that the corporate officials of the bankrupt were fully informed as to the nature of bankruptcy proceedings. The testimony of Ernest R. Utley, one of the attorneys for the bankrupt, conclusively demonstrates that they were fully advised by their counsel as to all of the ramifications of the bankruptcy proceedings and jurisdiction. In Mr. Utley's testimony he stated that he had been admitted to practice before the federal court since 1920 and that from 1936 until March of 1945 he had been a Referee in Bankruptcy; that he had numerous and extensive discussions pertaining to the notice of bankruptcy proceedings with Mr. Bell, the president and sole trustee of the bankrupt, and with Mrs. Knapp and Mrs. Nordskott, officers and directors of the bankrupt corporation who signed the voluntary petition. [Appellants' Tr. 99-109.][21]

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[21]See also the testimony of Arthur L. Bell, President, Director and Sole Trustee of the bankrupt corporation, contained in Appellants' Tr. pp. 81 to 97.

Regardless of the understanding of the corporate officials who caused the voluntary petition to be filed, no contention has been made, nor could any such contention be made, that the petition was not regular on its face, and any understanding which the corporate officials might have had with respect to the nature of their acts is no ground whatsoever to vacate the adjudication. As stated by this Court in *Matter of Fox West Coast Theatres* (88 F. 2d 212 at 230):

> "There was no allegation of extrinsic fraud. Consequently, there was no jurisdiction in the bankruptcy court to vacate its order of adjudication even if extrinsic fraud would justify such action. Second, the order of adjudication of bankruptcy followed as a matter of course upon the application therefor by the bankrupt. Consequently, no ground is alleged for the vacation of the order."

This Court had occasion to state the grounds upon which an adjudication in bankruptcy can be vacated in the *Matter of Larsen* (C. C. A. 9th, 1941), 124 F. 2d 121 at 122, 47 A. B. R. N. S. 787, where the court stated:

> "Having become final before appellants' petition was filed, the order of adjudication could be vacated only (1) for lack of jurisdiction, or (2) for extrinsic fraud. *In re* Fox West Coast Theatres (C. C. A. 9th Cir.), 33 A. B. R. N. S. 471, 88 F. (2d) 212, 221, 222.
>
> There was no lack of jurisdiction. Appellant was a person subject to being adjudged an involuntary

bankrupt. The involuntary petition alleged facts which warranted adjudication."

In a recent decision of the Third Circuit Court of Appeals (*In re Technical Marine Maintenance Co., Inc.* (1948), C. C. H. Bankruptcy Service, par. 562.41), certain creditors of a corporation filed an involuntary petition against it under Chapter X of the Bankruptcy Act, alleging that the corporation was insolvent and unable to pay its debts as they matured. An answer to the petition was filed by the corporation, in which it admitted that it was insolvent and unable to pay its debts, and, attached to its answer a resolution of the board of directors authorizing the admission of insolvency, together with a certificate that the resolution was a valid act of the corporation. Upon the basis of the petition and answer, and after a hearing, the court approved the petition and trustees were appointed. Thereafter, a lessor of the corporation came into the bankruptcy court and asked for an order terminating the corporation's lease, upon the ground that the lease contained a provision giving the lessor a right to terminate it if the tenant filed a petition in bankruptcy or was adjudicated a bankrupt or insolvent. The Bankruptcy Court ordered the lease terminated, and ordered the corporation to surrender possession of the property. Thereafter, the principal stockholder and a creditor petitioned the court for the vacation and setting aside of all proceedings, on the ground that the corporate officers had not realized that their lease could be terminated by the bankruptcy proceedings, and that if they had known that this

would follow they would not have consented to the adjudication of insolvency, because it would have frustrated any corporate reorganization. The trial court granted the motion as prayed, and on appeal the ruling was reversed. The court states that in ruling on a motion to vacate bankruptcy proceedings, the facts existing at the time the petition was filed must control, and nothing occurring thereafter can affect the original adjudication. In so holding the court states:

> "The fact that subsequent events have proven that a reorganization is not possible without possession of this property by the trustee under the lease can have no effect upon the good faith at the time when the order for reorganization was entered. All the other elements of 'good faith' prescribed by the statute were present. No adequate relief was obtainable under Chapter XI, and no prior proceeding was pending at the time. At the time of the consideration of the order of vacation, strong affidavits were filed by one of the petitioning creditors and one of the attorneys for debtor, showing that the petition was filed in the belief that it was best for debtor and all concerned. The answer filed by Technical [debtor] bearing evidence of appropriate authorization might also be cited as evidence of good faith of petitioners. In any event, the court passed upon the question of fact and no ground other than practical impossibility of reorganization at the present time has been suggested to accomplish its overthrow."

V.

The Appellants, With Full Knowledge of the Facts, Acquiesced and Participated in the Bankruptcy Proceedings From Their Inception for a Period of Approximately Two Years Before Making Any Objection to the Regularity of the Adjudication, and Thereby Have Been Guilty of Laches so as to Preclude Any Possible Right to the Relief They Seek.

For approximately two years prior to the making of the motion to vacate the adjudication, the bankrupt's estate had been administered under the supervision of the Bankruptcy Court. The administration was a very complicated one, with properties spreading over two states, California and Oregon, and with extensive litigation being undertaken and defended by the trustees both in the state courts and in the federal courts. Hundreds of claims have been filed in the estate, some of which were denied, some allowed, and some are still pending. Property has been sold, operated and leased; more than two million dollars have been received and disbursed by the trustees [Appellees' Tr. 38-44, 52]; the District Court found as a fact that appellants, and each of them, had been aware of the pendency of the bankruptcy proceeding since its inception on November 1, 1945. [Appellants' Tr. 124.] That finding has not been disputed by the appellants, and should, therefore, be accepted by this Court.[22] Notwithstanding that appellants had knowledge of these proceedings since their inception and had participated therein, they had made no

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[22]Subsection "d" of Rule 20 of the Rules of the Circuit Court of Appeals for the Ninth Circuit, see also O'Brien, Manual of Federal Procedure, Third Edition, page 208.

objection to the adjudication prior to the filing of their motion two years after the adjudication.

Solely on the basis of these undisputed facts, it is clear that the appellants' delay should of itself be a sufficient ground for denying their motion to vacate the adjudication. *No explanation has been offered by appellants as to why they waited approximately two years before initiating this proceeding.*

In the case of *Mason v. Dean* (C. C. A. 9th, 1929), 31 F. 2d 945, 13 A. B. R. (N. S.) 771, the moving parties waited for approximately six months before seeking to vacate the adjudication in bankruptcy. In holding that laches was a sufficient basis for denying the motion, the court stated:

> "We are of the opinion that the appeal should be dismissed on the ground that the petitioner's right to object to the adjudication was lost by laches. As already stated, the adjudication was made March 21, 1928, and the petition to vacate was not filed until September 24th following. There is no reason given for the delay in filing the petition. The objection to the jurisdiction does not appear on the face of the record, but depends upon facts which must be proven. An interested party cannot stand by and allow the administration of the estate to proceed until he considers that it will be to his advantage to avoid the adjudication. He must move against it promptly, if at all, and this the petitioner failed to do. *Rudebeck v. Sanderson* (C. C. A. 9th), 225 Fed. 575, 36 A. B. R. 146."

In the case cited by the court, *Rudebeck v. Sanderson*, there was a delay of approximately one year and three months, and the motion to vacate the adjudication was

based upon one of the same grounds made by the appellants in the instant case, to-wit, that the proper corporate officials had not signed the consent to adjudication. In affirming the trial court's refusal to vacate the adjudication, the court stated:

> "The petitioner Rudebeck had notice of the adjudication as early as March 23, 1914, because on that date he filed his claim against the corporation with the referee in bankruptcy. When the other petitioners received notice of the adjudication does not appear; but they could not stand idly by and permit the administration of the estate to proceed in the bankruptcy court until some step was taken that did not meet with their approval. Whether the petition in bankruptcy was filed by competent authority or not, it was the duty of the petitioners to move against it promptly, if at all, and this they failed to do." (Citing cases.)

There are many cases in accord.[23]

In the present case the vast holdings of the bankrupt and the complexity of the administration show that any setting aside of the adjudication would adversely affect hundreds of innocent people who have dealt with the

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[23] *In re Ives* (C. C. A. 6th), 113 Fed. 911, 7 A. B. R. 692;
Morales v. Todd (C. C. A. 1st), 79 F. 2d 601, 30 A. B. R. (N. S.) 290;
Alexander v. Farmers Supply Co. (C. C. A. 5th), 275 Fed. 824, 47 A. B. R. 302;
In re Bankshares Corp. (C. C. A. 2d), 55 F. 2d 335, 18 A. B. R. (N. S.) 471;
Globe Paper Co. v. Travis Drug Co. (C. C. A. 6th), 112 F. (2d) 350, 43 A. B. R. (N. S.) 200.

bankrupt estate. As stated by the Eighth Circuit Court of Appeals in *Smith v. The Chase National Bank of the City of New York* (1936), 84 F. 2d 608, 31 A. B. R. (N. S.) 472:[24]

> "For more than two years before appellants' petitions were filed, it [the bankruptcy court] had been administering these assets, and through its officers, conducting the extensive business of the bankrupts. It had collected their assets and passed upon the claims of their creditors, all of which had been paid, purchased, or in some way satisfied by the time the appellants' petitions were filed. The title of the trustee in bankruptcy to the assets was marketable, so that the assets could be sold, and offers had been made for them, which the court determined should be accepted." (84 F. 2d at 613.)

In the instant case numerous properties of the bankrupt had actually been sold to innocent parties. Clearly, the delay of the appellants in making their motion to vacate the adjudication is a sufficient ground for estopping them from having the adjudication set aside. We respectfully urge this contention without prejudice to our position that no legal or equitable basis has been proven by the appellants which would in any manner support their appeal.

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[24]Cited by appellants on page 23 of their opening brief. See also the discussion relating to this case appearing on pages 13 to 16, *supra*.

VI.

Vacating and Setting Aside the Order of Adjudication Is Not the Proper Remedy for Any Alleged Misconduct of the Trustees or Other Officers of the Bankruptcy Court in the Administration of the Bankrupt Estate Subsequent to the Order of Adjudication.

Appellants' principal contention, in support of their motion to vacate the adjudication, seems to be that the administration of the bankrupt estate by the trustees and the Bankruptcy Court has resulted in some sort of religious persecution. All the alleged acts complained of occurred after adjudication. The remedy for the improper administration of the bankrupt estate is not to vacate the adjudication. If there is any dissatisfaction with any ruling of the Bankruptcy Court, any aggrieved party has the right to take a review.[25]

Any alleged misconduct of the trustees can be brought to the attention of the court, and, upon a proper showing the trustees can be removed. Section 2a (17) of the

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[25]During the course of appellants' extensive offer of proof in which the alleged misconduct of the trustees and the Bankruptcy Court was referred to, the District Judge below stated [Appellants' Tr. p. 36]:

> "But have you chosen the proper method here? Anything the Referee does can be reviewed by this Court; anything this Court does can be reviewed by the United States Circuit Court of Appeals, and anything the United States Circuit Court of Appeals does can be reviewed by the Supreme Court of the United States.
>
> "If the Referee has made any improper order in this matter, it is open to review; if this Court has made any improper order it is open to review; if the trustees have abused their offices, isn't the remedy to remove the trustees?"

Bankruptcy Act (11 U. S. C. A., Sec. 11), reads as follows:

> "Courts of bankruptcy may: . . . (17) approve the appointment of trustees by creditors, or appoint trustees when creditors fail so to do; and, upon complaints of creditors, or upon their own motion, remove for cause receivers or trustees upon hearing after notice."

The rule laid down by this court in *Matter of Larsen* (C. C. A. 9th, 1941), 124 F. 2d 121, 47 A. B. R. (N. S.) 787, that an order of adjudication can be vacated only (1) for lack of jurisdiction, or (2) for extrinsic fraud, is a clear recognition that the motion to vacate is directed to facts existing at the time of the filing of the petition in bankruptcy. Nothing occurring thereafter can have any bearing upon the propriety of the adjudication.

This rule was recognized in the case of *McDonough v. Owl Drug Co.* (C. C. A. 9th, 1935), 75 F. 2d 45, *cert. den* 295 U. S. 750, where the court affirmed the trial court's denial of a motion by preferred stockholders of a bankrupt corporation to vacate a voluntary adjudication on the ground of extrinsic fraud. One of the contentions by the moving parties in that case was that fraud had been perpetrated in connection with the liquidation sale of the bankrupt estate, in that the bidding at such sale was "stifled." This court, in disposing of that contention stated:

> "Appellants are not attacking the sale and seeking to have the property resold at a sale where bidding

> will be fair and unrestricted. Appellants seek to annul the adjudication in bankruptcy to the end that the entire bankruptcy proceeding shall be a nullity. Obviously such is not the proper remedy for stifling bidding at a judicial sale." (75 F. 2d at 54.)

It would appear from the arguments made on pages 23 to 26 of appellants' opening brief that appellants are well aware of the fact that they have misconceived their remedy. Appellants argue that any vacation of the adjudication in the instant case would operate prospectively "to prevent any future misconduct . . . if for any reason the present remedy does not appeal to the Chancellor." None of the cases cited by appellants recognize such a procedure, and we have been unable to find any cases where such a rule is announced. Indeed, the very cases cited by appellants[26] are conclusive authority for the proposition that a vacation of an adjudication in bankruptcy is a judicial declaration that the adjudication was void *ab initio*.

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[26] *Smith v. Chase National Bank of the City of New York*, 87 F. 2d 608;
In re Fox West Coast Theatres, 88 F. 2d 212;
In re Ettinger, 76 F. (2d) 741,
all cited on pages 23 and 24 of Appellants' Opening Brief.

VII.

The Exercise of the Power to Vacate an Adjudication Rests in the Sound Discretion of the Bankruptcy Court, Reviewable Only for a Clear Abuse of That Discretion; No Abuse of Discretion Is Shown in the Present Record.

The record of the hearing in the court below shows that the court considered an extensive offer of proof made by the appellants herein and denied the motion. The written order of the court set forth the grounds therefor, and it is clear therefrom that there was no possible abuse of discretion in the ruling.

The applicable principles have been well stated by this Court in the leading case of *McDonough v. Owl Drug Co.* (C. C. A. 9th, 1935), 74 F. 2d 45, cert. den. 295 U. S. 750, in which this Court affirmed the District Court's denial of a motion by preferred stockholders of the bankrupt corporation to vacate and set aside a voluntary adjudication. The court stated (75 F. 2d at 53):

> "A proceeding of this character is addressed to the sound judicial discretion of the court and must be predicated upon considerations which will appeal to the conscience of a chancellor, and the relief sought will be granted or denied, depending upon what a careful balancing of all pertinent equitable factors dictates to be just. Let it not be forgotten that in liquidating a bankrupt corporation the rights of creditors come first. The interests of corporate stockholders in such proceedings are always secondary and subordinate to the interests of the corporate creditors. Indeed, it is only after the lawful claims of creditors are satisfied that the rights of stockholders attach for prac-

tical purposes. Unless there is a surplus over and above the amount necessary to satisfy creditors, there is nothing to which the stockholders may assert any claim. Creditors are the peculiar favorites of courts of bankruptcy. When a court of bankruptcy is asked to assert its incidental equity powers, its action must be governed by precisely the same principles and considerations which would move a chancellor to action. With these elementary principles in mind it does not seem difficult to chart a true course in this case. The learned trial court, in dismissing appellants' petition, stressed the question of laches and palpably, in face of the facts to which we have already adverted, there is much to be said in support of that view. However, we prefer to rest the determination of the controversy upon what we consider to be a broader and a more fundamental ground, viz., the want of equity in the petition in the light of the circumstances of the case in hand. It requires no unusually vivid imagination to picture measurably the consequences which would follow if the adjudication in question should be set aside. No creditor is complaining. No creditor has manifested any dissatisfaction with the adjudication, nor with the steps which have been taken in liquidating the estate. The creditors holding approved claims are relieved from the injurious effects of the onerous long-time leases made under conditions vastly different from those prevailing at the present time. Large sums have been expended in liquidating the estate which would be irretrievably lost if the adjudication should be annulled. The fund of $1,550,000, now in the custody of the court, would be withdrawn from

the creditors, and they would be launched upon a sea of chaos and confusion. They would be postponed in the enjoyment of their rights and be subjected to untold hazard, expense, delay and inconvenience. And all this to the end that preferred stockholders may speculate through protracted litigation, without regard to the hurt of creditors, in the hope that something may be salvaged for themselves. If it be suggested that claims of landlords have been rejected or reduced, the obvious answer is that such landlords are not complaining and appellants cannot be heard to complain in their behalf. If the adjudication should be set aside, the leases of these landlords would automatically be reinstated, and with these claims revived it is too plain for serious discussion that there would not be any surplus over and above the debts to which appellants could assert any claim. In these circumstances it would be inequitable, unconscionable, and unjust to subject the creditors to the evils and hazards which the cancellation of the adjudication would inevitably entail. The creditors of the bankrupt corporation are not involved in the fraud upon which appellants rely. The creditors are as innocent of the wrong complained of as are the appellants themselves. If the allegations of appellants' petition be taken for true, the creditors, like themselves, are the victims of a fraud, not the authors of it. The creditors have done nothing to harm or injure the appellants, and while courts of bankruptcy may, in the exercise of their incidental equity powers, preserve the integrity of their processes and protect themselves against fraud, trickery, and imposition, these

powers may not be invoked by one class of litigants to the injury, detriment, or hazard of another class who are themselves blameless, and especially is this true when the class sought to be adversely affected occupy a favored position and who possess rights of superior and paramount dignity to the class seeking the intervention of the court. In relieving against fraud the consequences must be laid at the door of those who perpetrate it."[27]

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[27]In the matter of *Fortnum & Mason, Inc.,* 85 F. 2d 519, 32 A. B. R. (N. S.) 11, the Sixth Circuit Court of Appeals states the rule as follows:

> "And so when the order below was made the court was faced with a situation where adjudication had been had upon a voluntary petition in bankruptcy which had been duly authorized, and filed by an insolvent corporation in the court having jurisdiction; and liquidation of its assets had been practically completed when the appellants filed their petition to intervene and set the adjudication aside. Whether or not the petition should be granted was to be decided in the sound discretion of the court. *Banco Commercial De Puerto Rico v. Hunter Benn & Company* (C. C. A. 1st Cir.), 14 Am. B. R. (N. S.) 95, 31 F. 2d 921. It is apparent that the appellants did not establish facts entitling them to affirmative relief and that there was no abuse of discretion in denying their petition. *In re De Lue* (C. C. A. 1st Cir.), 3 Am. B. R. (N. S.) 479, 295 F. 130."

The case presented a factual situation very similar to the one involved in the instant case. In that case the corporation had filed a voluntary petition in bankruptcy and an adjudication was had thereon the same day. Shortly thereafter a trustee was elected who took over the assets and sold practically all of them in order to wind up the business through liquidation. Almost two months later a petition was brought by three preferred stockholders of the bankrupt corporation to vacate the adjudication on the ground that the controlling stockholder of the bankrupt had caused the bankrupt, although in fact solvent, to file its petition in bankruptcy for the fraudulent purpose of permitting such a controlling stockholder to cancel a certain contract that it had with the bankrupt, to the prejudice of the petitioners and other preferred shareholders of the bankrupt corporation. The court held that it was no abuse of discretion

A glance at the record in the instant case demonstrates that the court below properly exercised its discretion in denying the motion of appellants. We have heretofore pointed out the vast property holdings of the bankrupt, and the complexity of the administration. As stated by the United States Supreme Court in *Wayne United Gas*

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to deny the petition to vacate the adjudication under these circumstances.

In *Banco Commercial De Puerto Rico v. Hunter Benn & Co.,* 31 F. 2d 921, 14 A. B. R. (N. S.) 95, the First Circuit used the following language:

> "It is apparent that the refusal of the court to grant leave to the bank to file an answer after the decree of adjudication had been entered is of no moment, unless its refusal to vacate the decree was erroneous.
>
> It was discretionary with the District Court whether it would or would not vacate the decree of adjudication. And its refusal to do so presents no question for review on this appeal under section 24b, in the absence of a showing that it abused its discretion. *In re De Lue* (C. C. A., 1st Cir.), 3 Am. B. R. (N. S.) 479, 295 F. 130; *Blackstone v. Everybody's Store* (C. C. A., 1st Cir.), 30 Am. B. R. 497, 207 F. 752.
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> The court did not abuse its discretion in refusing the bank's request to vacate the decree. The petition in bankruptcy was filed October 18, 1927, and was made returnable November 2, 1927. Within five days after the return day the bank could have filed an answer, as a matter of right, or procured a reasonable extension of the time for so doing. Section 18b (11 U. S. C. A. §41b). It did neither of these things, but waited until March 16, 1928 (some 4½ months after the return day) and until after a decree had been entered. It then asked that the decree be vacated and that it be permitted to intervene and answer the petition. These facts do not show an abuse of discretion, but a proper exercise of it."

In *Smith v. Chase National Bank,* 84 F. 2d 608, 31 A. B. R. (N. S.) 484, the court states:

> "Assuming, without deciding, that appellants had a sufficient interest in the proceeding to ask that the adjudication be vacated, we are satisfied that, under the circumstances, the court was guilty of no abuse of discretion in refusing to entertain the petitions in so far as they sought to vacate the adjudication."

See also *In re First National Bank of Belle Fourche* (C. C. A. 8th, 1907), 152 Fed. 64, 18 A. B. R. 265.

Co. v. Owens-Illinois Glass Co. (1937), 57 S. Ct. 382, 33 A. B. R. (N. S.) 1, at 7:

> "The rule which governs the case is that the bankruptcy court, in the exercise of a sound discretion, *if no intervening rights* will be prejudiced by its action, may grant a rehearing upon application diligently made and rehear the case upon the merits." (Emphasis added.)

The rule is succinctly stated by the Eighth Circuit Court of Appeals in the case of *Wharton v. Farmers & Merchants National Bank* (1941), 119 F. 2d 487, 45 A. B. R. (N. S.) 813, at 817:

> "The rule is that an erroneous order made during the progress of a bankruptcy proceeding, although not appealed from, may subsequently be set aside and vacated unless rights have become vested in reliance upon it which will be disturbed by its vacation. Sandusky v. National Bank, 90 U. S. 289, 292-293; Wayne United Gas Co. v. Owens-Illinois Glass Co., 300 U. S. 131, 136-137; Reber v. Home Owners' Loan Corp. (C. C. A. 8th Cir.), 36 A. B. R. (N. S.) 297, 96 F. (2d) 77, 78-79."

The most recent pronouncement of this principle which we have been able to find was made by the Third Circuit Court of Appeals in *In re Technical Marine Maintenance Co.* (April, 1948), C. C. H. Bankruptcy Service #56,241, where the court reversed an order of the trial court which had vacated an involuntary adjudication in bankruptcy at the request of a stockholder and a creditor, on the

ground that they did not understand the nature of the proceedings or the result that would follow. The court states:

> "An order which would have been set aside upon appeal, or which the court which granted it would have vacated before the situation changed, will not be disturbed where rights have vested in consequence of the entry thereof, because it is impossible to re-establish the pre-existing status and because powers which then sprang into being have been exercised and have founded rights in third parties."

In that case the court felt, as did the court below in the instant case, that the vacation of the adjudication would cause injury to innocent third parties.

Conclusion.

We respectfully submit that each and every one of the foregoing grounds is of itself sufficient to uphold the ruling of the District Court.

Wherefore, appellees pray that the order of the District Court be affirmed by this court.

Respectfully submitted,

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